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# Online Auction Fraud: Are the Auction Houses Doing All They Should or Could to Stop Online Fraud?

James M. Snyder

*Indiana University School of Law*

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# NOTE

## Online Auction Fraud: Are the Auction Houses Doing All They Should or Could to Stop Online Fraud?

James M. Snyder\*

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\* B.A., Mary Washington College, 1996, *cum laude*; J.D., Indiana University School of Law—Bloomington, 1999, *cum laude*. James Snyder is employed at Wooden & McLaughlin LLP, Indianapolis, Indiana. Mr. Snyder wishes to thank Professor Fred Cate for his guidance, Meggan Frye for her persistence in bringing this piece to publication, and Jeanne and Elizabeth for their love and support.

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## I. INTRODUCTION

In April 1998, the Federal Trade Commission (FTC) released a consumer alert pertaining to the increasing problem of online auction fraud. The consumer alert notified prospective online auction users that fraud was becoming more prevalent as the number of online auction participants burgeoned. The FTC, in the consumer alert, suggested tips that the consumer should consider when bidding in an online auction. Since this consumer alert, the online auction industry's awareness of fraud has grown considerably. While the FTC has had limited success in policing the auctions and bringing prosecutions of fraudulent merchants, little has been done to address whether or not the provider of the online auction site should be held accountable for providing the arena in which the fraudulent practices occur.

Part II of this Note examines the online auction industry and the fraud that is becoming all too commonplace. Statistical evidence clearly indicates that online auction fraud is continuing to grow. Part II then identifies a variety of different fraudulent practices that frequently occur in connection with online auctions. While not an exhaustive list of all the different possibilities of fraud, there is a representative group of practices that will clearly indicate the creativity associated with online auction fraud. Faced with the prospect of online auctions becoming a breeding ground for the unscrupulous and ill willed, Part III of this Note is a detailed analysis of the various efforts to stop online auction fraud. The online auction houses themselves, as well as consumer protection groups, and the FTC have undertaken efforts to curb fraudulent use of the online auction sites. Part IV undertakes a comparative study between online auction fraud and the abuse of the pay-per-call industry in the early 1990s. FTC officials warn that the near demise of the 900-number industry due to fraudulent use could be a foreshadowing of the fate of online auctions if the FTC does not promptly address the fraud occurring online. In Part V, this Note ultimately concludes that the existing efforts of online auction industry self-regulation do not provide adequate recourse against the online auction houses for fraudulent practices occurring on their Web sites. The only effective

method to stop the increase of online auction fraud is for the FTC to promulgate guidelines and standards that would put the industry on notice that its members will be held responsible for future acts of online auction fraud committed through the use of their Web site.

## II. COMPLAINTS OF ONLINE AUCTION FRAUD INCREASE AS THE PERPETRATORS BECOME MORE CREATIVE

### A. *Statistical Evidence of the Increase in Online Auction Fraud*

Nothing evinces the urgency of curtailing the spread of online auction fraud more than the increase in complaints over the past three years. Both the FTC and the Internet Fraud Watch (IFW), operated by the National Consumers League (NCL), serve as reporting agencies for consumer complaints pertaining to fraud.

According to Lisa Hone, staff attorney for the FTC, using Internet-based auctions to defraud people is "a new type of crime."<sup>1</sup> "Hone said that in the first half of 1998, the FTC's Bureau of Consumer Protection received about [three hundred] complaints involving online auction fraud."<sup>2</sup> In the first half of 1999, the FTC's Bureau recorded about six thousand complaints.<sup>3</sup> This represents a two thousand percent increase in just one year's time.

According to Susan Grant, director of the IFW project, the number of reports alleging auction fraud are increasing at its offices as well.<sup>4</sup> Consumer complaints to the IFW regarding online auctions increased 600% from 1997 to 1998.<sup>5</sup> In 1997, constituting 26% of the total frauds reported, auctions were the number one Internet fraud complaint.<sup>6</sup> While online auctions maintained the number one ranking in 1998, the percentage of reports pertaining to auctions increased to an alarming 68%.<sup>7</sup> This 68% represents nearly 5500 consumer complaints about fraudulent practices occurring on an online auction site.<sup>8</sup> In 1998, approximately two-thirds of

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1. Marilyn Geewax, *Swindlers Cash in with Net Auctions*, ATLANTA J. & CONST., Oct. 24, 1999, at A9.

2. *Id.*

3. *See id.*

4. *See id.*

5. *See* Internet Fraud Watch, *Going Once, Going Twice . . . Scammed! Online Auctions Named the Number One Internet Fraud Complaint for 1998* (visited Jan. 18, 2000) <<http://www.fraud.org/internet/9923stat.htm>> [hereinafter *Scammed!*].

6. *See id.*

7. *See id.*

8. *See* Mo Krochmal, *Bidding Frenzy: What You Need to Know About Internet Auctions* (visited Jan. 18, 2000) <<http://www.netguide.com/Snapshot/Archive?guide>>

all Internet-related complaints to the IFW involved auctions and, as of October 1999, 90% of consumer complaints to the IFW pertain to auctions.<sup>9</sup>

The increase in the number of complaints can be attributed to several factors. As the number of Web sites devoted to online auctions increases, it is predictable that the number of frauds occurring on those Web sites will likewise increase. Currently, well over one hundred online auction sites are dedicated to bringing together consumers with other consumers as well as businesses with consumers.<sup>10</sup>

eBay, one of the most popular sites on the Internet, accommodated more than 6.5 million unique visitors in February 1999.<sup>11</sup> With traffic this heavy, eBay was able to consummate more than one million auctions per day on a consumer-to-consumer basis.<sup>12</sup> eBay officials maintain that problems with fraud are extremely rare.<sup>13</sup> eBay reports that only twenty-seven of the more than one million auctions per day generate a fraud complaint to the company.<sup>14</sup> This equals nearly ten thousand fraudulent transactions per year. More generally, in 1998, online auction sites accounted for auction sales amounting to roughly two billion dollars, and analysts expect that by the end of next year that figure will more than triple.<sup>15</sup>

Another factor that explains the increase in fraud associated with online auctions is the lack of adequate external law enforcement. As the number of sites offering online auction services increases, there is a commensurate rise in the need for better policies. However, one of the difficulties in stopping fraudulent activities and outright theft is that auctions have grown far more quickly than law enforcement budgets.<sup>16</sup>

Regardless of the reason for the increase in the number of consumer complaints pertaining to online auction fraud, it is clear that someone must take the steps necessary to thwart the spread of this new crime. With external resources already stretched thin, a more appropriate and efficient

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=Shopping&id=1600>.

9. See Geewax, *supra* note 1, at A9.

10. See Krochmal, *supra* note 8. eBay and Amazon.com represent the most popular online auction sites providing the arena for consumer-to-consumer auctions. Meanwhile, for business-to-consumer auctions, the most frequently visited sites are Onsale.com and uBid.com. See *id.*

11. See *id.*

12. See *id.*

13. See George Anders, *How eBay Will Battle Sham Bids, Mislabeling of Auction Goods*, WALL ST. J., Jan. 15, 1999, at B1.

14. See *id.*

15. See Geewax, *supra* note 1, at A9.

16. See *id.*

method of enforcement would be to require the Web site operator to police its users. Requiring the online auction houses financially liable for fraudulent actions occurring through the perpetrator's use of their Web site is the only way to impact the online auction houses.

### *B. Online Auction Fraud: How Does It Happen?*

Fraudulent practices can occur during two distinct phases of the online auction process. First, the fraud can take place during the actual bidding process. Two types of fraud at this stage are bid shielding and bid shilling.<sup>17</sup> Second, the fraud can occur after the auction has ended with a buyer having made a winning bid. Three methods are commonly used to perpetrate this fraud. The buyers may send payment to the seller and receive no merchandise at all. The buyers may send payment to the seller and receive inferior or completely different merchandise. Finally, the buyer may win the auction but never send any payment.

#### **1. Fraud During the Bidding Process**

Bid shilling occurs when "an individual schemes with someone else or creates a false identity in order to drive up the bidding prices on behalf of the seller."<sup>18</sup> The effect of this fraudulent practice is to artificially encourage legitimate bidders to continually increase their bid in an effort to win the auction. Many times the individual creating a false identity is the seller who then bids on its own merchandise in an effort to increase the overall price received for the goods.

Bid shielding takes place when a buyer and a partner artificially inflate the bids during an auction.<sup>19</sup> Unlike bid shilling, which hopes to encourage increasingly higher bids, this scheme of bid inflation is intended to discourage other bidders from bidding because the false bid is set at an unusually high level. Then, at the last moment before the auction ends, the shielder, who is the high bidder, cancels its high bid whereby his/her partner wins the auction with the lower bid.<sup>20</sup> For example, Bidder A bids five dollars for merchandise being auctioned, while Bidder A's partner, Bidder B, bids five-hundred dollars for the same merchandise. This high bid discourages any other honest bidders from participating in the auction. Then, just before expiration of the auction, Bidder B withdraws his bid, leaving Bidder A as the high bidder with a bid of only five dollars.

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17. *utrade.com, utrade Online Auction—Fraud Policy Page* (visited Oct. 29, 1999) <<http://www.utrade.com/user/fraud.htm?AssociateID=2500>>.

18. *Id.*

19. *See id.*

20. *See id.*

## 2. Fraud After the Close of the Auction

The winning bidder sending payment to the seller and receiving nothing in return is the most common type of fraud occurring after the close of an auction. Some online sellers have put items up for auction, taken the highest bidder's money, and never delivered the merchandise. In addition, consumers who paid by certified check or money order have little recourse when it comes to getting their money back.<sup>21</sup> With fraudulent online auction users recognizing the difficulty in retrieving a check or money order, it is not surprising that payment by check or money order accounts for ninety-three percent of fraudulent payments.<sup>22</sup> In other words, as Susan Grants proclaims: "Requesting cash is a clear sign of fraud."<sup>23</sup> The FTC alleged that Craig Lee Hare perpetrated this type of fraudulent practice on successful bidders for his advertised computer hardware and software. After the successful bidder mailed his check/money order to Hare, Hare sent nothing in return.<sup>24</sup>

Another form of postauction fraud occurs when the high bidder mails payment to the seller only to have the seller send either different merchandise or merchandise of lower quality to the bidder.<sup>25</sup> While the bidder receives some merchandise, the goods the consumer receives are usually of such poor quality that the purchase is virtually worthless. The FTC also alleged this form of merchandise switching as part of its complaint against Hare.<sup>26</sup>

One final form of fraud that occurs after the close of an auction is when the successful bidder fails to send any payment to the seller. It is not unheard of for the high bidder in an auction to walk away from the offer and refuse to complete the transaction.<sup>27</sup> While the direct cost of these frauds is not as apparent as frauds involving payment made for either nothing or inferior goods, the indirect effects are grave. The cost of having to run an entirely new auction from scratch causes delay for the sellers in their attempts to sell their goods. Furthermore, all disreputable actions cast

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21. See FTC, *FTC Consumer Alert! Online Auctions: Going, Going, Gone!* (visited Jan. 18, 2000) <<http://www.ftc.gov/bcp/online/pubs/alerts/gonealrt.htm>>.

22. See *Scammed!*, *supra* note 5.

23. *Id.*

24. See Complaint for Injunction and Other Equitable Relief, *FTC v. Hare*, Civil No. 98-8194 (D. Fla. 1998), *available at* (visited Jan. 18, 2000) <<http://www.ftc.gov/os/1998/9804/compl3.htm>>. For a more detailed discussion of this case, see *infra* Part III.C.

25. See Geewax, *supra* note 1, at A9.

26. See Complaint for Injunction and Other Equitable Relief, *FTC v. Hare*, Civil No. 98-8194 (D. Fla. 1998), *available at* (visited Jan. 18, 2000) <<http://www.ftc.gov/os/1998/9804/compl3.htm>>.

27. See Anders, *supra* note 13, at B4.

a cloud of distrust over the online auction system as a whole, thereby undermining what little consumer confidence currently exists.

### III. VARIOUS PARTIES ARE ATTEMPTING TO STOP ONLINE AUCTION FRAUD

Efforts to prevent the continued proliferation of online auction fraud come from many sources. Three specific groups are addressed below, each having as a common goal the end of fraud, but all attempting to achieve that goal through different means. Some of the approaches taken are similar, while others are unique to the industry undertaking the effort. The three groups consist of the online auction houses themselves, consumer protection groups, and the FTC.

#### A. *The Online Auction Houses' Efforts to Self-regulate*

As Susan Grant stated, the auction hosts "have a moral responsibility to keep their sites from being used for fraud."<sup>28</sup> The online auction industry has taken steps to implement both industry-wide goals as well as Web site-specific goals. While there is some overlap, it is worthwhile to separate the overall goals of the industry from the specific efforts individual Web site providers are implementing to combat Internet fraud.

#### 1. Online Auction Industry Goals to Prevent Fraud

In response to the FTC's request for academic papers and public comments on December 16, 1998,<sup>29</sup> eBay submitted a paper to aid the FTC in its consideration of the development of private sector measures to effectively address consumer concerns about fraud.<sup>30</sup> In this comment, eBay succinctly identified desirable industry-wide goals for implementing adequate safeguards to combat online fraud associated with auctions.<sup>31</sup>

Electronic transactions in general, and auctions in particular, present new consumer protection challenges for responsible firms.

eBay and other e-commerce businesses can meet that challenge by developing creative programs to provide consumers with: (1) online information to evaluate the safety and reliability of a transaction, (2) targeted safeguards to protect against unscrupulous users, and (3)

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28. Geewax, *supra* note 1, at A9.

29. See FTC, Public Workshop: U.S. Perspectives on Consumer Protection in the Global Electronic Marketplace Notice, 63 Fed. Reg. 69,289 (1998).

30. See eBay, Inc. Comment, FTC v. Hare, Civil Action No. 98-8194 (S.D. Fla. 1998) (visited Jan. 18, 2000) <[http://www.ftc.gov/bcp/icpw/ comments.ebay.htm](http://www.ftc.gov/bcp/icpw/comments.ebay.htm)> [hereinafter *eBay Comment*]. eBay submitted this paper in response to the FTC's solicitation for comments.

31. See *id.*



easily comprehensible online programs and policies designed specifically to combat fraud, deception and misuse.<sup>32</sup>

These goals are incredibly broad yet succinct enough to be considered ambitious. They provide some guidance as to what individual members of the online auction community should strive toward in an effort to stop fraudulent practices.

## 2. Individual Web Site Efforts to Combat Fraud

eBay has been the most outspoken online auction house regarding its efforts to curtail the spread of fraud on its Web site. While all of the guidelines mentioned below are directly attributable to eBay, the general scheme and overall policies are echoed throughout the industry.<sup>33</sup> In its comments to the FTC, eBay declared its commitment to effective self-regulation and to the proactive implementation of programs and policies to empower and protect consumers.<sup>34</sup> To achieve this empowerment, eBay, as well as others on the inside and outside of the industry, continually echo the same fraud prevention devices.<sup>35</sup>

Soon after the founding of eBay, Pierre Omidyar, eBay's chairman, developed a rating system to provide a feedback forum for auction users.<sup>36</sup> Members could submit short messages about one another, which are tallied as positive or negative feedback and posted as a member's score. The thinking behind this system was that "the desire to build up a good score—and thus be known as a trustworthy trading partner—would be strong enough" in each user that they would treat one another fairly.<sup>37</sup> However, the validity and value of the feedback system has been strained at times. Some members have inflated their own scores by having their friends leave favorable evaluations, even though they have never done business together.<sup>38</sup> Some members are sometimes apprehensive about leaving negative feedback for fear that recipients would strike back with a negative

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32. *Id.*

33. On the *utrade.com* website, the fraud policy is very explicit. While not being too explanatory, the policy is simply zero tolerance. After investigating a complaint and the allegations are found to be correct, its policy is to suspend the user on the first offense. The website also maintains a blacklist to chronicle the errant users. *utrade.com*, *supra* note 17.

34. *See eBay Comment*, *supra* note 30.

35. Many articles and other information have been written either merely citing or even applauding the efforts of eBay. *See, e.g., Anders*, *supra* note 13; Audri Lanford & Jim Lanford, *Internet Scambusters Snippets* (visited Jan. 18, 2000) <<http://www.scambusters.com/Scambusters28.html>>.

36. *See Anders*, *supra* note 13, at B4.

37. *Id.*

38. *See id.*

comment, tarnishing their online reputation.<sup>39</sup> In response to these concerns, eBay is now changing its feedback system to only tally comments relating to actual transactions.<sup>40</sup>

To proceed even further with consumer safeguards, eBay proposes the following additional protections: (1) provide customers with free insurance against fraud or mislabeling of goods with a twenty-five-dollar deductible and two hundred dollars of coverage;<sup>41</sup> (2) make it easier for customers to take advantage of independent escrow services, especially for large transactions;<sup>42</sup> (3) allow users the option of having their identities verified by an independent party, Equifax, Inc.;<sup>43</sup> (4) ban sellers from bidding in their auctions;<sup>44</sup> (5) establish stronger sanctions against bidders who win an auction and then do not pay for the item;<sup>45</sup> and (6) offer free mediation services to eBay members for qualified disputes.<sup>46</sup>

eBay has yet to enact these initiatives and their ultimate effectiveness remains to be seen. The enumerated guidelines seem comprehensive and, if fully and faithfully implemented, would aid in the prevention of online auction fraud. The main concerns, however, are two-fold. First, some of the

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39. *See id.*

40. *See id.*

41. *See id.* Lloyd's of London will underwrite the insurance on eBay. Consumers who feel they were materially misled about what was for sale will submit claims to eBay. It will then forward the claims to Lloyds if they seem valid. *See id.*

42. *See id.* Currently, eBay offers online links to two escrow companies that will hold a customer's payment until word is received that the goods have arrived safely. Fewer than one percent of eBay customers use those service, regarding them as expensive and cumbersome. *See id.*

43. *See id.* Verification would result in a user then being certified on eBay as "accredited." Users would pay five dollars and submit their driver's license and Social Security numbers. The data would be kept private, but participants would be rewarded with a special badge next to their names, indicating that their full identities had been verified. *See id.*

44. *See id.* The company has historically allowed one such bid, because sellers claimed to have friends who wanted to participate in an auction but were not online. With the growing popularity of the Internet, though, that justification is fading. *See id.*

45. *See id.* In one embarrassing case, teenagers who submitted bids exceeding \$100,000 with no intention of paying hijacked a charity auction sponsored by eBay. Company officials say they will reprimand first-time offenders and will suspend users who repeatedly make frivolous bids. *See id.*

46. *See eBay Comment, supra* note 30. Disputes that qualify include receipt of damaged items, disputes over the quality of merchandise and disputes over shipping or payment terms. *See id.* One clear problem with mediation is that in the physical world, alternative dispute resolution is conducted "in the shadow of the law." The threat of court or governmental involvement is helpful in bringing parties to the table. In the online world, dispute resolution is not conducted in the shadow of the law because national law throws few shadows in cyberspace. *See* Ethan Katsh Comment, *FTC v. Hare*, Civil Action No. 98-8194 (S.D. Fla. 1998) (visited Jan. 18, 1999) <<http://www.ftc.gov/bcp/icpw/comments/ethankatsh.htm>>.

prohibitions and resulting sanctions occur after the fraud has taken place. Effective methods of prevention must be more proactive. Second, there is no external regulatory structure to ensure that these policies are carried out in a fair and consistent manner. Until eBay is faced with the threat of some personal liability, there is no incentive for it to guarantee a fraud free auction site.

### *B. Consumer Protection Groups' Efforts to Inform the Consumer*

Numerous consumer protection groups have undertaken efforts to provide as many Internet auction users as possible with basic information to ensure their experience online is both profitable and enjoyable. The IFW has been working directly with eBay and other online auction sites to improve consumer safety and stop fraud.<sup>47</sup>

In addition to helping the online auction houses implement effective fraud prevention policies, various consumer protection groups have published tips intended to help the consumer stay one step ahead of the fraudulent auction user.<sup>48</sup> The IFW has published nine comprehensive tips that if followed should protect the average online auction user:<sup>49</sup> (1) "Understand how the auction works;"<sup>50</sup> (2) "Check out the seller;"<sup>51</sup> (3) "Be especially careful if the seller is a private individual;"<sup>52</sup> (4) Confirm a physical address and other identifying information;<sup>53</sup> (5) "Ask about delivery, returns, warranties[,] and service;"<sup>54</sup> (6) "Be wary of claims about collectibles;"<sup>55</sup> (7) Use common sense as a guide;<sup>56</sup> (8) "Pay the safest

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47. See *Scammed!*, *supra* note 5.

48. These consumer protection groups include the IFW, Internet Scambusters, National Fraud Information Center, and Better Business Bureau Online. Each group provides advice for the consumer on how to avoid being susceptible to online auction fraud.

49. See Internet Fraud Watch, *Online Auction Tips* (visited Jan. 18, 2000) <<http://www.fraud.org/internet/inttip/aucttip.htm>> [hereinafter *Auction Tips*].

50. *Id.* Many online auctions simply list items that people want to sell. They do not verify if the merchandise actually exists or is described accurately.

51. *Id.* The auction site's feedback section provides valuable comments about the seller. However, glowing reports could be "planted" by the seller, and a clean complaint record does not guaranty that someone is legitimate.

52. *Id.* Most consumer protection laws and government agencies that enforce them do not deal with private sales, so if there is a problem, it could be impossible to resolve.

53. See *id.* The tips suggest that the buyer attempt to obtain the seller's name, street address, and telephone number to research them or follow up if there is a problem. IFW cautions the buyer about doing business with sellers who will not provide that information.

54. *Id.* This site further suggests that the buyer obtain a definite delivery time, insist that the shipment is insured, and ask about the return policy. If the buyer plans to purchase electronic goods or appliances, IFW recommends inquiring about a warranty and how to get service for the item.

55. *Id.* IFW warns the potential buyer about any claims regarding the item given that it is impossible to examine or appraise the item until after the sale. IFW advises that the buyer

way;"<sup>57</sup> and (9) "Let the auction site know if you have a problem."<sup>58</sup>

This list of consumer advice is important and encourages online auction users to obtain all relevant and helpful information available before entering into any auction transaction. The online auction Web sites are also attempting to craft fraud prevention procedures with an eye toward furthering these consumer protection goals. However, pains involved in addressing the millions of consumers and placing the consumers "on guard" is both further removed and ultimately more cumbersome than a comprehensive legal structure pointed directly at the limited number of online auction site hosts.

### C. *The FTC's Efforts to Combat Online Auction Fraud*

Eileen Harrington, Associate Director in the FTC's Bureau of Consumer Protection, stated that the FTC pursues "its mission of promoting the efficient functioning of the marketplace by seeking to protect consumers from unfair or deceptive acts or practices and to promote vigorous competition."<sup>59</sup> The Federal Communication Commission (FCC) believes it is important to address Internet fraud now, before it discourages consumers from participating in the impressive commercial growth now in progress on the Internet.<sup>60</sup> Consumers must feel confident that the Internet is safe from fraud. Nothing is more likely to undermine consumer confidence than exploitation by scam artists using this new technology as yet another means to defraud consumers.<sup>61</sup>

The FTC views protection from online auction fraud as the most

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insist on a written statement describing the item and its value before paying for it.

56. *See id.* The buyer should ask if what the seller promises seems realistic; whether it is this the best way to buy this item; and what is the most reasonable to bid for it.

57. *Id.* If the seller requests cash, this is a clear sign of fraud. If possible, the buyer should pay by credit card because the charges may be disputed if the goods are misrepresented or never arrive. Alternatively, the buyer could use an escrow agent, who acts as a go-between to receive the merchandise and forward payment to the seller. Another option is cash on delivery (COD). In addition, IFW states that the buyer could pay with a check made out to the seller, as opposed the post office, so the buyer could stop payment if necessary.

58. *Id.* Some sites investigate problems like "shills" being used to bid prices up or other abuses of the auction system. They may also want to know about sellers who do not deliver or misrepresent their wares. A bad record may result in a seller being barred from using the site again.

59. *Consumer Protection in Cyberspace: Hearings Before the Subcomm. on Telecomms., Trade, and Consumer Protection of the House Comm. on Commerce*, 105th Cong. 245 (1998) (prepared statement of Eileen Harrington, Associate Director in the Bureau of Consumer Protection, FTC) [hereinafter *Harrington Statement*].

60. *See id.* at 246-47.

61. *See id.*

meaningful when three aspects are working together.<sup>62</sup> First, law enforcement must be coordinated against fraud and deception.<sup>63</sup> Second, private initiatives and public/private partnerships must cooperate and focus on resolving the problem.<sup>64</sup> Last, the FTC calls for consumer education through the combined efforts of government, business, and consumer groups.<sup>65</sup> Since the second and third aspects mirror the discussion in the two earlier parts of this Note, the discussion of the FTC's efforts focuses solely on its targeted law enforcement initiative.

The FTC has the authority to issue administrative complaints and conduct administrative adjudications that may ultimately culminate in the issuance of cease and desist orders against practices deemed to be unfair and deceptive.<sup>66</sup> In addition, in cases involving fraud, the FTC has statutory authority to file suit directly in federal district court to obtain preliminary and permanent injunctive relief, redress for injured consumers, or disgorgement of ill-gotten gains.<sup>67</sup>

In *FTC v. Hare*,<sup>68</sup> the court issued a temporary restraining order and froze the assets of an Internet merchant who used online auction houses to offer merchandise but never delivered the goods to the consumers.<sup>69</sup> Hare used online auction houses to offer new and used computers for sale. After successful bidders paid as much as \$1450 per computer, Hare provided them neither the computer nor a refund.<sup>70</sup> The FTC alleged that Hare's actions violated both the FTC Act and the Mail or Telephone Order Merchandise Rule.<sup>71</sup> The FTC Act bars "deceptive or misleading acts in commerce," while the "Mail or Telephone Order Merchandise Rule requires that sellers ship merchandise in a timely manner—a specified time or [thirty] days—or offer to refund consumers' money."<sup>72</sup>

FTC-initiated prosecutions are becoming increasingly common. With the favorable result in *Hare*, it is clear that the FTC is capable of protecting the consumer in some sense. However, civil actions brought against individuals can only be so effective. Rather than investigating every

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62. See *id.* at 245.

63. See *id.*

64. See *id.*

65. See *id.*

66. See *id.*; 15 U.S.C. § 45 (1994).

67. See *id.*; 15 U.S.C. § 53(b) (1994).

68. Civil No. 98-8194 (D. Fla. 1998).

69. See FTC, *FTC Halts Internet Auction House Scam* (visited Jan. 18, 2000) <<http://www.ftc.gov/opa/1998/9804/hare.htm>>.

70. See *id.*

71. See *id.*

72. *Id.*

individual case of fraud, it would be much more efficient and ultimately beneficial to the consumer if the FTC turned the focus of its attention on the auction houses themselves. Making the auction houses responsible for the fraudulent conduct would implore them to take all steps necessary to protect the consumer.

#### IV. THE POTENTIALLY PERILOUS FATE OF ONLINE AUCTIONS IF IMMEDIATE ACTION IS NOT TAKEN

As demonstrated throughout this Note, the existing safeguards and multiple proposed guidelines ultimately fail to attack the issue of online auction fraud at its source. The individual auction house's self-regulation attempts to solve the problem by setting up rarely used and cumbersome programs that are only initiated if the consumer chooses. The consumer protection groups have no real authority and only hope to educate the consuming public. The FTC has limited resources and cannot afford to prosecute every individual fraudulent online auction user. For obvious reasons, these three lines of defense ultimately fail to provide the consumers with the protection from fraud they should be entitled to expect. The most efficient method available for stopping online auction fraud is to establish liability with the one entity most capable of ending the fraudulent practice: the online auction house.

As Eileen Harrington stated:

The Internet's promise of substantial consumer benefits is, however, coupled with the potential for fraud and deception. Fraud operators are always opportunists and are among the first to appreciate the potential of a new technology. This phenomenon was illustrated by the advent, flourishing, and near-demise of pay-per-call (900-number) technology as a commercial medium during the last decade.<sup>73</sup>

The same attributes that made pay-per-call services so attractive to fraudulent users—low start-up costs and the potential for big profit—exist on the Internet today.<sup>74</sup> The FTC and FCC permitted the 900-number industry to attempt self-regulation and only upon its failure did strict regulations become necessary. A brief review of the near demise of the pay-per-call industry will clearly illustrate the dangers of permitting industry self-regulation regarding fraudulent use of the industry's services.

##### A.. *The Initial Regulation of Pay-Per-Call Technology*

The FCC first adopted regulations governing interstate pay-per-call

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73. *Harrington Statement*, *supra* note 59, at 246.

74. *See id.*

services<sup>75</sup> in 1991 to address consumer complaints of widespread industry abuse involving 900-number services.<sup>76</sup> The fraudulent practices included overbilling consumers, failing to disclose what service the consumer was actually paying for, and threatening phone service disruption if the consumer did not promptly pay the disputed phone charges. The telephone industry's inability or unwillingness to provide adequate consumer safeguards to its customers forced the FCC to enact these rules. Without any substantive threat of repercussion, the industry was without the motivation necessary to adequately address the abuses and insure that fraud would no longer be permitted. These regulations were a result not only of the numerous consumer complaints but also the increase of competitive interactive services the industry offered.<sup>77</sup> Increases in both competition and technology induced some service providers to take suspect measures to procure increased revenues.

The FCC specifically intended for the promulgation of these new regulations to protect the consumer from the fraudulent and misleading billing practices of 900-number and other pay-per-call services. The FCC proposed numerous protective measures which included requiring pay-per-call programs to begin with a preamble, disclosing in a clearly understandable and audible voice the name of the information provider, the cost of the services, and a brief description of the product.<sup>78</sup> Pay-per-call

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75. The term "pay-per-call services", commonly referred to as "900 services", is defined at 47 U.S.C. § 228(i) (Supp. II 1996) as any service:

(A) in which any person provides or purports to provide—

(i) audio information or audio entertainment produced or packaged by such person;

(ii) access to simultaneous voice conversation services; or

(iii) any service, including the provision of a product, the charges for which are assessed on the basis of the completion of the call;

(B) for which the caller pays a per-call or per-time-interval charge that is greater than, or in addition to, the charge for transmission of the call; and

(C) which is accessed through use of a 900 telephone number or other prefix or area code designated by the [FTC].

In addition, the Commission may extend the definition to other similar services providing audio information or audio entertainment if the Commission determines that such services are susceptible to the unfair and deceptive practices that are prohibited by the rules prescribed pursuant to 15 U.S.C. § 5711 (1994). These services generally offer callers recorded and interactive information and entertainment programs that carry charges in excess of the charge for transmitting the call.

76. See Policies and Rules Concerning Interstate 900 Telecomms. Servs., *Report and Order*, 6 F.C.C.R. 6166, para. 2, 69 Rad. Reg.2d (P & F) 1360 (1991) [hereinafter *900 Telecomms. Servs. Report and Order*].

77. See Policies and Rules Concerning Interstate 900 Telecomms. Servs., *Notice of Proposed Rulemaking*, 6 F.C.C.R. 1857, para. 2 (1991).

78. See *900 Telecomms. Servs. Report and Order*, 6 F.C.C.R. 6166, para. 92, 69 Rad. Reg.2d (P & F) 1360.

service providers and common carriers were to give callers an opportunity to disconnect the call prior to incurring any charges.<sup>79</sup> In addition, the regulations required local exchange carriers (LECs) to offer telephone subscribers the option of blocking access to pay-per-call services, either through a 900 number or other designated FCC approved calling prefix.<sup>80</sup> Furthermore, the FCC's regulations prohibited common carriers from disconnecting basic telephone service for a customer's failure to pay pay-per-call charges.<sup>81</sup> The FCC was now holding pay-per-call service providers and common carriers accountable for the once burgeoning problem of misinforming and abusing their communications customers.

### *B. Further Efforts to Address the Pay-Per-Call Industry*

#### *1. The Telephone Disclosure and Dispute Resolution Act*

On October 28, 1992, President Bush signed into law the Telephone Disclosure and Dispute Resolution Act (TDDRA).<sup>82</sup> The purported purpose of the TDDRA was to "protect the public interest and the future development of interstate pay-per-call . . . technology by providing for the regulation and oversight of the applications and growth of the pay-per-call industry."<sup>83</sup> This Act was in response to Congress's growing consideration for protecting consumers in the increasingly sophisticated and unintelligible sphere of complex telecommunications technology. The TDDRA required the FCC to adopt stricter regulations pertaining to the provision of interstate pay-per-call services.<sup>84</sup> The FCC adopted new regulations governing the role of common carriers in the provision of interstate pay-per-call services. The FCC subsequently replaced its existing pay-per-call rules<sup>85</sup> with a set of entirely new statutory regulations, satisfying the congressional directive.<sup>86</sup>

The most significant obstacle for the FCC was to adopt these new

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79. See 47 C.F.R. § 64.711, *repealed by Policies and Rules Implementing the Tel. Disclosure and Dispute Resolution Act, Report and Order*, 8 F.C.C.R. 6885, 73 Rad. Reg.2d (P & F) 790 (1993) [hereinafter *TDDRA Report and Order*].

80. See 47 C.F.R. § 64.713, *amended by TDDRA Report and Order*, 8 F.C.C.R. 6885, paras. 55-63, 73 Rad. Reg.2d (P & F) 790 (current version 47 C.F.R. § 64.1508 (1998)).

81. See 47 C.F.R. § 64.714, *amended by TDDRA Report and Order*, 8 F.C.C.R. 6885, paras. 49-54, 73 Rad. Reg.2d (P & F) 790 (current version 47 C.F.R. § 64.1507 (1998)).

82. See Telephone Disclosure and Dispute Resolution Act § 201, 15 U.S.C. § 5711 (1994).

83. H.R. REP. NO. 102-430, at 2 (1992).

84. See Telephone Disclosure and Dispute Resolution Act § 201.

85. These rules were codified at 47 C.F.R. §§ 64.709-64.716 (1998).

86. The new rules are codified at 47 C.F.R. §§ 64.1501-1515 (1998).



regulations pursuant to the TDDRA in a manner that would maximize the consumers' protection against pay-per-call service providers' unfair and deceptive practices while ensuring a minimal disruption to common carriers and other providers of lawful and legitimate pay-per-call services.<sup>87</sup> The new regulations provided several requirements that common carriers must meet. First, common carriers and information providers must offer all interstate pay-per-call services through telephone numbers on the 900-service access code.<sup>88</sup> Second, common carriers and information providers cannot assess information service charges against callers to 800 and other toll free numbers unless either those callers have established a pre-subscription agreement with the information services provider or at the time of the call the consumer executes a transaction through a credit or charge card.<sup>89</sup> Third, common carriers carrying interstate pay-per-call services must promptly terminate programs not in compliance with the newly enacted federal law or regulations.<sup>90</sup> Fourth, common carriers must establish toll free pay-per-call information lines and provide pay-per-call disclosure statements to all subscribers on an annual basis.<sup>91</sup> Fifth, common carriers must clearly separate pay-per-call charges from normal telephone charges on subscriber bills<sup>92</sup> and neither local nor long-distance telephone service may be disconnected for a customer's failure to pay pay-per-call charges.<sup>93</sup> Finally, where technically feasible, common carriers must offer telecommunications subscribers the option of blocking all access to interstate pay-per-call services from their telephone lines.<sup>94</sup>

These regulations provided the consumer with concrete protections from the industry member's most common abusive tactics. Based on the FCC's belief that with enough information the consumer could intelligently choose whether or not to participate in the pay-per-call service, disclosure became a focal point of the regulations. The FCC effectively protected the consumer from several discrete fraudulent practices while causing only minimal interruption to lawful pay-per-call service providers.

## 2. Section 228 of the Telecommunications Act of 1996

Congress enacted section 228 of the Telecommunications Act of 1996

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87. See *TDDRA Report and Order*, 8 F.C.C.R. 6885, 73 Rad. Reg.2d (P & F) 790 (1993).

88. See 47 C.F.R. § 64.1506.

89. See *id.* § 64.1504.

90. See *id.* § 64.1503.

91. See *id.* § 64.1509.

92. See *id.* § 64.1510 (1998).

93. See *id.* § 64.1507 (1998).

94. See *id.* § 64.1508 (1998).

(1996 Act) "to put into effect a system of national regulation and review that will oversee interstate pay-per-call services[] and to recognize the [FCC]'s authority to prescribe regulations and enforcement procedures and conduct oversight to afford reasonable protection to consumers of pay-per-call services and to assure that violations of Federal law do not occur."<sup>95</sup>

Congress's prior promulgation of the TDDRA had proven effective against eliminating some specific abuses in the industry. However, with the alleviation of some exploitation, some unscrupulous members of the telecommunications industry promptly discovered new innovative methods to defraud their unsuspecting customers. These service providers' new-sprung method of deception involved exploitation of the 800-number and other traditional toll-free prefixes.

The 1996 amendments to section 228 were to ensure that abuses involving the use of toll-free numbers did not thwart the protective measures Congress established through the TDDRA.<sup>96</sup> The 1996 Act's amendments to section 228 "protects unsuspecting callers from being charged for 800 calls that they expect to be toll-free."<sup>97</sup> Pursuant to the enactment of the 1996 Act, the FCC amended portions of its rules governing interstate pay-per-call and other information services.<sup>98</sup> The road to the FCC's realization that restrictive guidelines were necessary to effectively regulate the 900-number industry was fraught with novel forms of fraud, abuse, and deception.

Given that the opportunity to self-regulate did not spell an end to the abuses of the 900-number industry, the FCC responded after months of wasted consumer resources and defrauded customers and finally implemented strict industry-wide guidelines. The implementation of these guidelines was not entirely successful as certain cunning industry participants found ways around the new procedures. These innovations were similarly met with even stricter guidelines that eventually significantly alleviated the 900-number industry of fraud and once again made it a useful and viable industry.

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95. 47 U.S.C. § 228(a)(1)-(2) (Supp. II 1996).

96. See Policies and Rules Governing Interstate Pay-Per-Call and Other Info. Servs. Pursuant to the Telecomms. Act of 1996, *Order and Notice of Proposed Rulemaking*, 11 F.C.C.R. 14,738, para. 14, 3 Comm. Reg. (P & F) 953 (1996) [hereinafter *Pay-Per-Call Servs. Order*].

97. S. REP. NO. 104-230, at 202 (1996).

98. See *Pay-Per-Call Servs. Order*, 11 F.C.C.R. 14,738, para. 1, 3 Comm. Reg. (P & F) 953.

## V. CONCLUSION: INDUSTRY SELF-REGULATION WILL NOT WORK

If the Internet is to avoid a fate similar to that of the 900-number industry, namely a marked decrease in consumer confidence and participation, the FTC must address Internet fraud now.<sup>99</sup> Self-regulation, whether of the 900-number industry or of the online auction industry, will not be effective in preventing fraudulent users from abusing the consumer.

Not surprisingly, the online auction houses are strenuously arguing for a laissez faire government approach, vigorously pursuing a self-regulation standard. On *utrade.com*'s fraud policy page, the site explicitly states, "[s]elf-regulation is the best prevention against fraud. We will make every effort to enforce our fraud policy and we encourage our Auctions Online community to join us . . . If you don't complain, there exists a possibility that we don't know. Let's all take a stand!"<sup>100</sup>

In its comment to the FTC eBay states:

In the highly dynamic Internet marketplace . . . private firms such as eBay are in the best position to design and implement creative programs to respond to consumer complaints about fraud, deception[,] and misuse. Therefore, both domestic and foreign government agencies should resist the temptation to impose regulations on online marketplaces and other forms of e-commerce in an effort to extend consumer protection to this new form of commerce. Effective consumer protection efforts<sup>101</sup> are much more likely to emerge from industry self-regulation . . .

The problem with the industry's request for an opportunity to self-regulate is inherent in its plea that it is best equipped to curtail online fraud. The industry participants are either not the best suited to stymie the spread of online auction fraud or they are incredibly slow to recognize the need for action and take steps to implement their plans. The number of fraudulent transactions associated with online auctions has grown from year to year and continues to grow today.

The NCL stated that it applauds self-regulatory efforts such as the BBBOOnline program and the codes of conduct developed by trade groups such as the Direct Marketing Association because they encourage good business conduct and reduce the potential for fraud and abuse.<sup>102</sup> "However, self-regulatory schemes can never substitute for an appropriate legal

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99. See *Harrington Statement*, *supra* note 59, at 246.

100. *utrade.com*, *supra* note 17.

101. *eBay Comment*, *supra* note 30.

102. See National Consumers League General Comments, *FTC v. Hare*, Civil Action No. 98-8194 (S.D. Fla. 1998) (visited Nov. 27, 1999) <<http://www.ftc.gov/bcp/icpw/comments/ncl.htm>>.

framework of consumer protection and redress because they are voluntary. Not all businesses participate in them, and some participants fail to comply with the standards that they have pledged to uphold."<sup>103</sup>

In order to handle the growing problem of online auction fraud definitively, the FTC must come forth with a succinct legal framework to guide the industry in its pursuit of fraud free transactions. The FTC should mandate certain procedures that every online auction house must follow in order to escape the potential for being liable if a fraudulent transaction occurs.

First, the identity of every seller and buyer must be confirmed through either Equifax or another similarly functioning credit agency. Rather than encouraging sellers to undertake this certification for a fee, the auction house should provide free-of-charge access to this validation process. Consumer confidence in the validity of the auction will result in higher bids and monies ultimately collected for the items entered in the auction. These higher bids translate into higher commissions, which is perhaps the best motivation for the online auction houses.

Second, the online auction house must require affirmative proof of not only the purported existence of the merchandise, but also that the quality of the good is the same as the seller claims. This authentication process may even involve procedures as thorough as requiring the auction house to establish localized holding houses where all auctioned merchandise may be inspected prior to the commencement of the auction.

Third, the online auction house should provide free escrow service to be channeled through the localized holding houses. If the auction house implemented this service, a representative of the auction house would oversee the transfer of the money for the auctioned merchandise. This would ensure not only prompt delivery but also the winning bidder receiving the goods for which they have paid.

Finally, the penalties against the online auction houses for providing a place, albeit a place in cyberspace, where fraudulent actions are permitted to occur must be swift and severe. The consumer can no longer be held to the standard of *caveat emptor* in the arena of online auctions. By the very nature of the business, there is never an opportunity to inspect the goods. It would not be equitable to place such an onerous burden as *caveat emptor* on the bidders when the auction houses are in a much better position to insure the accuracy of the transaction.

Undoubtedly, there will be costs to all participants associated with the auction houses' implementation of any of these safeguards. For some of the

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103. *Id.*

measures, however, the cost will be offset by the higher prices generated by the auction and delivered to the seller. The higher prices will be a direct result of the increase in consumer confidence relating to the accuracy and validity of the online auction process. As a result of higher bids, the online auction houses will receive higher commissions from each successful online auction.

Some of the suggested measures may ultimately prove cost prohibitive for the online auction community to implement. If this is so, the spirit of the suggested guidelines should prevail. Every participant should undertake all necessary procedures to ensure the most complete information about every other participant. Cooperation and communication on every end will result in greater use of online auctions, an outcome sure to please the online auction houses as well as the individual. Cooperation begets currency.

No matter what the FTC ultimately decides to do, one thing is clear. The final guidelines must place liability upon the online auction house itself. The auction house is clearly in the best position to oversee and police the entire auction community to which it plays host. Rather than chasing the numerous fraudulent users and continuing to strain already too thin law enforcement agencies, the most efficient and effective method to end online auction fraud is to hold the hosts of the very place where the fraud occurs liable for the actions of its users. Once liability has attached, the online auction house will be quick to implement strict user policies in an effort to end the very harm its Web site fosters.